

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **201136007**  
Release Date: 9/9/2011

Index Number: 115.00-00

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, ID No.  
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Refer Reply To:  
CC:TEGE:EOEG:EO1  
PLR-143108-10  
Date:  
May 16, 2011

Authority:

City:

County:

Trust:

Agreement:

State:

Dear :

This letter responds to a letter from your authorized representative dated July 15, 2010, submitted on behalf of the Authority and the City, requesting rulings that (1) the Trust's income is excludable from gross income under § 115 of the Internal Revenue Code, and (2) benefits provided and premiums paid will not constitute taxable income to retired employees or their beneficiaries. The Authority represents the following facts.

**Issue 1 – § 115(1)**

**FACTS**

The Authority is responsible for regulating and administering the water and wastewater utility of the City and the County. The City is responsible for local governmental operations within its geographical boundaries. Both entities are political subdivisions of the State.

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The Authority and the City (jointly, the Employer) have provided life insurance for their retired employees for many years as part of their compensation package. The Employer proposes to set up the Trust to fund this post-employment benefit. Upon receipt of a favorable ruling letter from the Service, the City intends to adopt an ordinance implementing and adopting the Agreement.

Under the Agreement, the Board of Trustees is composed of the City's then-acting Investment Committee. The committee consists of five members, of whom one is the City's Director of Finance and Management, one is the City's Treasury Officer, two are appointed by the City's Chief Administrative Officer from within the City government, and one is a representative of the Authority. A trustee ceases to serve as trustee when he ceases to serve as a member of the committee. The Employer may remove a trustee for any reason, with or without cause.

The board and each investment manager is to discharge his duties solely in the interest of the employees and their beneficiaries, for the exclusive purpose of providing post-employment life insurance benefits.

The board may set aside from Employer contributions (which are irrevocable) and investment income a reasonable sum for Trust operating and administrative expenses. All remaining funds coming into the Trust shall be set aside, managed, and used only for the payment of post-employment insurance benefits.

The board delegates to the administrator the responsibility for making payments from the Trust.

No private interests may participate in, or benefit from, the operation of the Trust.

The Agreement may be amended with prospective effect and in writing at any time by a majority vote of the board, but not to change the purpose of the Trust or to permit the diversion or application of any trust funds for purposes other than those specified in the Agreement.

The Agreement may be terminated at any time by the board when all participation interests of the Employer have been terminated. In no instance will any assets remaining after termination be distributed to an entity other than a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115(1).

#### LAW AND ANALYSIS

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Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) was excludable from gross income under § 115. In Rev. Rul. 90-74, private interests neither materially participated in the organization nor benefited more than incidentally from the organization.

The Trust was established and is maintained by the Employer as a separate entity to provide life insurance benefits to its retired employees and their beneficiaries. Providing such benefits to former public employees constitutes the performance of an essential governmental function within the meaning of § 115(1). See Rev. Rul. 90-75 and Rev. Rul. 77-261.

The provision of life insurance benefits to retirees and their dependents satisfies the obligation of the Employer to provide those benefits as part of the employees' compensation; thus, the income of the Trust accrues to the benefit of the Employer, with the Authority and the City comprising the Employer being political subdivisions. No private interests participate in, or benefit from, the operation of the Trust, other than as providers of goods and services. Any amounts remaining in the Trust after all life insurance benefits, plus reasonable fees and expenses, have been paid shall in no event be paid to any entity other than a state, political subdivision, or § 115 entity. The benefit to retired employees of the Employer is incidental to the public benefit. See Rev. Rul. 90-74.

## **Issue 2 – §§ 79 and 101**

### **FACTS**

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The Employer intends to establish a trust to provide group-term life insurance to its retired employees. The life insurance will be provided through a life insurance contract with a commercial life insurance company. No retiree will receive more than \$50,000 of life insurance coverage.

### LAW & ANALYSIS

The taxation of employer-provided group-term insurance on the life of an employee is governed by § 79. Assuming a group-term plan meets the non-discrimination requirements of § 79(d),<sup>1</sup> \$50,000 of such coverage is excludable from the each employee's income. For coverage above \$50,000, § 79 requires an employee to include in income an amount equal to the cost of life insurance provided under a policy carried directly or indirectly by his or her employer (less any amounts paid by the employee toward the purchase of such insurance). Pursuant to § 79(e), the term "employee" includes a former employee, such as a retiree.

Section 1.79-1(a) of the Income Tax Regulations sets forth the conditions that must be met before life insurance will be considered group term life insurance for purposes of § 79, including that it provides a general death benefit that is excludable from gross income under § 101(a). Section 1.79-1(a)(1).

Section 83 provides rules for the taxation of property transferred in connection with the performance of services. Section 83(e) states that the rules of § 83 do not apply to group term life insurance to which § 79 applies.

Pursuant to §§ 101(a)(1) and § 1.101-1(a)(1), subject to exceptions not relevant to this ruling request, proceeds of life insurance policies, if paid by reason of the death of the insured, are excluded from the gross income of the recipient.

### CONCLUSION

Based solely on the facts and representations submitted by the Employer:

1. We conclude that the income of the Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Consequently, we rule that the Trust's income is excludable from gross income under § 115(1).
2. We conclude that the life insurance coverage is excluded from the gross income of the retiree under § 79. Thus, we rule that premiums paid to

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<sup>1</sup> The § 79 nondiscrimination requirements do not apply to a governmental plan. See § 416(i)(1)(A).

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the Trust to provide the life insurance benefit will not constitute taxable income to the retirees.

3. We conclude that the death proceeds paid to the retirees' beneficiaries are excluded from gross income under § 101(a). Thus, we rule that the death benefits will not give rise to taxable income for the recipient retiree or the retiree's family.

Except for the specific rulings above, no opinion is expressed or implied regarding the federal tax consequences of the facts of this case under any other provision of the Code.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

SYLVIA HUNT  
Assistant Chief  
Exempt Organizations Branch 2  
Office of Division Counsel /  
Associate Chief Counsel  
(Tax Exempt & Government Entities)

Enclosures: copy for § 6110 purposes